

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

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POSTAL RATE AND FEE CHANGES, 2006

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Docket No. R2006-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA  
TO INTERROGATORY OF  
DISCOVER FINANCIAL SERVICES & MORGAN STANLEY  
(DFS&MSI-T31-1)

The United States Postal Service hereby files the responses of witness  
O'Hara to above-listed interrogatory, filed on July 12, 2006.

The interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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Chief Counsel, Ratemaking

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August 3, 2006

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA TO  
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DISCOVER FINANCIAL SERVICES & MORGAN STANLEY**

**DFS & MSI-T31-1**

Please refer to page 13 and 14 of your testimony where you discuss "Degree of Preparation."

- a. Please confirm that work-shared mail tends to be more cost efficient for the Postal Service to handle than non-work-shared mail.
- b. Please confirm that as the degree of worksharing in a class or subclass increases over time, the cost coverage for that class must be increased if the Postal Service is to maintain the same institutional contribution of that class or subclass.
- c. Please confirm that the consequence of the dynamic discussed in part (b) of this interrogatory is that the cost coverage of a subclass with a greater-than-average increase in worksharing will need to increase relative to the system-average coverage if and only if the Postal Service wishes to maintain the institutional cost contribution of that subclass.
- d. Please confirm that the net effect of the dynamics discussed in parts (b) and part (c) of this interrogatory is to, over time, increase the *relative* institutional cost burden of work-shared mail more than that of non-workshared mail.
- e. Please confirm that the net effect of the dynamics mentioned in parts (b) through (d) of this interrogatory is that the more efficient mail becomes, the greater its relative institutional cost burden becomes.
- f. Would not economic efficiencies tend to be more strongly encouraged if the relative burden of work-shared mail did not increase as that mail becomes more efficient?

**RESPONSE:**

I think the discussion below will be easier to follow if the following simplifying assumptions are used: (1) the *only* things that change are the proportion of workshared mail in a subclass and, as a result, the *total* volume-variable cost of that subclass. However, (2) volume-variable cost *per piece* for is fixed for each level of worksharing within a subclass, (3) mail volume in each subclass is fixed, and (4) total institution cost is fixed.

- a. Not confirmed as stated because the term "cost efficient," as I understand it, does not fit the context in which you use it. I can confirm that workshared mail costs the Postal Service less per piece to collect,

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- process, and deliver than non-workshared mail (of similar shape, weight, service standard, etc.).
- b. Confirmed. If the cost coverage is not increased to a level that achieves the same contribution per piece as before, some of the institutional cost burden will have to be shifted to other subclasses. In a sense, increasing the cost coverage of a subclass by a particular amount is the result of a decision to retain the previous distribution of the institutional cost burden across subclasses, not a policy objective in itself.
- c. I confirm the "if" portion of statement, but do not confirm the "only if" portion, at least as a general statement. "Only if" would seem to deny the possibility of any other reason to raise a subclass's cost coverage relative to the system average.
- d. Not confirmed. In this case, changes in cost-coverage are not a good indicator of shifts in relative institutional cost burden. The subclass with an above-average increase in worksharing (and an appropriate increase in cost-coverage) will nevertheless be paying the same amount toward institutional cost as before, both per piece and for the subclass a whole.
- e. Not confirmed, for the reason stated in my response to part (d).
- f. Not applicable. A subclass's institutional cost burden does not increase unless and until its cost coverage is increased *beyond* the level needed to retain the same per piece contribution to institutional cost as worksharing increases.

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On the other hand, a policy that retained the preexisting percentage cost coverages as worksharing increased would actually reduce the subclass's institutional cost burden, forcing an increased burden on other subclasses. To translate from the above set of simplifying assumptions to real world situations where items (2) through (4) do change, the "no change in contribution per piece" benchmark for retaining the pre-existing distribution of the institutional cost burden across subclasses should be replaced by "no change in contribution per piece *as a percentage total institutional cost.*"

My point is not that the distribution of the institutional cost burden should never change; it is only that, in many situations, unchanged cost coverages are not the right starting point for evaluating shifts of the institutional cost burden. A better starting point is a set of coverages obtained by modifying pre-existing cost coverages as needed to achieve the pre-existing contributions per piece (or pre-existing contribution per piece *as a percentage total institutional cost*"). These adjusted coverages can then be raised or lowered as necessary for total contribution to equal institutional cost, and then modified individually as warranted by the nine pricing criteria.